Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Federal-State Joint Conference on Accounting Issues	))))	WC Docket No. 02-269

COMMENTS OF AT&T CORP.

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Pursuant to the Federal-State Joint Conference ("Joint Conference") *Notice*,[1] AT&T Corp. submits these comments supporting the retention and strengthening of the Commission's accounting regulations to ensure that the Commission and state regulatory agencies can effectively carry out their regulatory responsibilities, including their responsibility to protect the public and ratepayers from anticompetitive behavior on the part of dominant local exchange carriers ("LECs").

INTRODUCTION AND SUMMARY

Accounting scandals and monopoly abuses have undermined public confidence in the telecommunications industry. Accordingly, shortly after the Chairman was appointed to the President's Corporate Fraud Task Force, the Commission convened a Federal-State Joint Conference on Accounting issues "to engage in a thorough analysis of the Commission's accounting requirements to ensure that regulatory accounting information is adequate and truthful and to ensure that information captured in the regulated accounts is both necessary and sufficient for regulatory purposes." *Notice* at 2. And, pending the Joint Conference's

[1] Public Notice, *Federal-State Joint Conference On Accounting Issues*, WC Docket No. 02-269, DA 02-3449 (rel. Dec. 12, 2002) ("*Notice*").

recommendations, the Commission suspended portions of earlier orders, which had reflected the Commission's "prior efforts" that were heavily focused "on eliminating [accounting] reporting requirements." *Id*.

As detailed below, the Commission should now take a number of steps to strengthen existing accounting and reporting requirements and, in a few instances, to reinstate requirements that were recently repealed. At a time when most of the country's lawmakers and regulators are pursuing a variety of actions designed to strengthen accounting requirements to ensure that large corporations are subject to appropriate accounting and auditing controls it would be truly remarkable for the Commission, at this time, to take the diametrically opposite path and *relax* critically important accounting regulations in the telecommunications industry.

Part I of these comments addresses the Joint Conference's inquiries regarding the purpose of regulatory accounting requirements and the Commission's authority to impose such requirements under the Communications Act ("Act"). Regulatory accounting and reporting requirements serve multiple purposes. Disaggregated and precisely defined record-keeping and reporting requirements are necessary to protect consumers and competition against discrimination, cross-subsidization, and other market power abuse by dominant carriers, to allow the Commission to implement effectively the Act's universal service requirements, and to ensure that price cap and other regulation of interstate services protects consumers from unjust and unreasonable rates and practices. Regulatory accounting requirements also permit states to carry out their equally important regulatory responsibilities. But record keeping and reporting requirements can serve those vital roles only if carriers are required to report relevant accounting data in a sufficiently disaggregated and structured means that allows regulators to distinguish among services, affiliates and different types of expenses, revenues, assets and liabilities.

That is precisely why the Act directs the Commission to adopt a uniform system of regulatory accounts, 47 U.S.C. § 220, and provides the Commission broad discretion to require other regulatory accounting and reporting standards to implement the goals of the Act, including the authority to adopt accounting regulations that are used primarily – or even exclusively – by states. Congress contemplated a *uniform* system of accounts that would address both federal and state needs in regulating networks used to provide both interstate and intrastate services. Moreover, because the Commission's accounting and reporting requirements continue to play an extremely important role in protecting the public interest in the face of enduring local bottlenecks, the Act's biennial review requirement, 47 U.S.C. § 161 ("Section 11"), which could be triggered in this context only if there was sufficient "meaningful economic competition" to make a particular accounting requirement no longer "necessary in the public interest," *id*., never comes into play.

Given the important role of regulatory accounting information, it is vital that carriers fully comply with regulatory accounting requirements. Unfortunately, it is clear that dominant incumbent LECs often do not take these accounting and reporting requirements seriously. To address these problems, and to deter future anticompetitive and unlawful conduct, the Commission should increase the frequency with which it audits LEC accounts. Such audits are especially important today, as the dominant incumbent LECs are increasingly obtaining authorization to enter competitive markets which depend upon the incumbent's local bottleneck facilities as inputs. The incentives and ability to discriminate and cross-subsidize are therefore stronger than ever and effective record-keeping and reporting requirements are essential to deter and detect such misconduct.

Part II of these Comments identifies some of the specific items that should be included (or reinstated) in the dominant LECs' regulatory accounts. These and other accounting and recording requirements remain vital to ensuring that the Commission and states are able to carry out their core regulatory responsibilities. Furthermore, these requirements do not impose any undue burden on the dominant incumbent LECs.

I. REGULATORY ACCOUNTING IS A CORNERSTONE OF ENSURING COMPETITIVE TELECOMMUNICATIONS MARKETS.

1. Purpose of Regulatory Accounting. A primary purpose of regulatory accounting requirements is to protect consumers and competition against the exercise of market power. Incumbent LECs retain exclusive control over local bottleneck facilities that are essential to the provision of most telecommunications services. The incumbent LECs have strong incentives, and the ability, to abuse their control over those bottleneck facilities both to deter entry into local markets and also to gain artificial competitive advantages in other markets. Effective regulatory accounting and reporting requirements provide the Commission with the information necessary to design regulations that deter such anticompetitive conduct, and to monitor and audit the incumbents' compliance with those nonstructural safeguards.

Regulatory accounting and reporting requirements are more important today than ever before.[2] New technologies and deregulation have allowed incumbent LECs increasingly to enter competitive markets – *e.g.,* long-distance, wireless and broadband markets – creating additional opportunities for incumbents to abuse their control over the bottleneck local facilities that are necessary inputs in those other markets. And it is only through detailed and strictly enforced

[2] *See Notice* at 5 (seeking comment on the "role of the regulatory accounting at the present stage in the movement from a [telecommunications industry characterized by] regulated monopol[ies] towards an increasingly competitive communications market").

accounting and reporting requirements, accompanied by rigorous audits, that the Commission and state regulators can enforce prohibitions against anticompetitive abuses of market power.

Unlike financial accounting requirements, which often authorize highly aggregated data collection and reporting, the Commission's regulatory accounting rules are designed to detect anticompetitive activities, such as discrimination and cross-subsidization of rates in competitive markets with profits from non-competitive markets. That requires highly specialized and disaggregated data collection and reporting.

Moreover, as the Commission and states seek to minimize regulation and maximize competition in the telecommunications industry, they need sufficient information to develop pro-competitive policies and to assess whether those policies are working. The information contained in the dominant carriers' regulatory accounts is often the only source of such information.

Recent proceedings illustrate the usefulness of the existing regulatory accounts for protecting competition. For example, the Commission recently relied on the incumbent LECs' regulatory accounts to thwart an attempt by those LECs to obtain unwarranted deregulation that could have imposed hundreds of millions of dollars of costs on their access customers (who also happen to be their competitors). Riding the wave of the WorldCom bankruptcy, these incumbents complained to the Commission that they faced increased risk of non-payment for access services by interexchange carriers, and requested that the Commission allow them virtually unfettered discretion to collect massive "security" deposits from their access customers. A central issue in that proceeding was whether the Bells actually faced substantial increased risks of non-payment of access bills. The Bells' regulatory accounts held the answers. Those accounts showed that the Bells' claims of vastly increased payment defaults by IXCs were greatly exaggerated, and that overhaul of tariff deposit requirements was entirely unnecessary, and contrary to the public interest.[3]

Regulatory accounts are also instrumental in assessing whether policies based on predictive judgements are consistent with reality. For instance, in 1999 the Commission predicted that facilities-based competition for special access service would be sufficient to discipline the Bells' exercise of market power over those facilities.[4] Based on this prediction, the Commission substantially deregulated the prices that the Bells are permitted to charge for special access services. *Id*. The regulatory accounts, however, confirm that the Commission's initial predictions were wrong – there is not sufficient facilities-based competition to prevent Bells' from exercising market power over those services. The Bells' ARMIS data show that the Bells' special access returns and revenues per line are rapidly increasing while the Bells' per line costs of providing special access service are rapidly *declining*.[5]

Even aside from protecting consumers and competition from the exercise of market power, the Commission's regulatory accounts serve other important functions. For example, the Commission's regulatory accounts are used to administer the Commission's universal service program. The regulatory accounts also provide the Commission with information needed to ensure that incumbent local exchange carriers are charging "just and reasonable" rates for

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[3] *See* Policy Statement, *Verizon Petition for Emergency Declaratory and Other Relief*, WC Docket No. 02-202, ¶¶ 18-21 (rel. December 23, 2002).

[4] Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform, et al.*, 14 FCC Rcd. 14221 (1999).

[5] *See* Petition of AT&T, *Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM-10593 (filed October 18, 2002); AT&T Reply Comments, *Petition for Rulemaking To Reform Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, RM-10593 (filed January 23, 2003).

interstate services. And the regulatory accounts are used by the Commission to implement the price cap mechanism.[6]

2. Federal and State Roles In Collecting Regulatory Accounting Data. Like federal regulators, state regulators also rely heavily on federal record-keeping and reporting data to carry out their responsibilities under the Act, including setting intrastate rates, enforcing affiliate transaction rules, and implementing cost-based wholesale rates.[7] The importance of this data to state commissions cannot be overstated. For example, implementing the Act's cost-based pricing requirements for unbundled network elements requires states to develop cost-studies that estimate forward-looking costs of various telecommunications services. And virtually all such cost studies – including the Commission's own universal service cost model – rely on the Bells' ARMIS data as a starting point. The ARMIS data currently are the only source of *uniform* cost data that allows both the Commission and states to identify the Bells' costs in their respective jurisdictions. Without the type of uniform accounting data contained in the ARMIS reports, each state would have to design its own record-keeping reporting requirements in order to wrestle the

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[6] *See* Report and Order in CC Docket Nos. 00-199, 97-212, and 80, 286; Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286, *2000 Biennial Regulatory Review – Comprehensive Review of Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, 16 FCC Rcd. 19911, ¶¶ 10-12 (2001) ("*Phase II Order*").

[7] *See, e.g., Phase II Order* ¶ 20 ("T]he Commission has developed an accounting system that almost every state uses. . . . For example, the State of Alaska uses [the accounts] . . . to determine local service rates as well as for evaluating unbundled network elements. . . . Alaska also uses the [accounts] . . . to determine intrastate access charges, evaluate the allocation of Alaska Universal Service Support, and evaluate proposed tariffs").

necessary information away from the Bells. Obviously, that would be extremely burdensome, both to state commissions and to the Bells.[8]

The Joint Conference (at 4) seeks comment on the Commission's and states' respective roles in establishing consistency in minimum regulatory standards nationwide. Congress plainly contemplated that the Commission, after conferring with states, would be responsible for establishing uniform accounting and reporting requirement standards. The Act expressly requires the Commission to "prescribe a uniform system of accounts" and further permits the Commission to "prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the Act." 47 U.S.C. § 220(a). And "[t]he Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations." *Id.* § 220(i). Moreover, Congress clearly intended for the Commission, not the states, to ensure the accuracy and reliability of those accounts. The Act provides the Commission with monitoring enforcement mechanisms for failure to properly maintain accounting records in the manner required by the Commission. *Id.* § 220(c)-(g).

It is clear, therefore, that the Act does *not* preclude the Commission from implementing regulatory accounting measures that primarily, or even solely, benefit the states. On the contrary, the fact that Congress requires the Commission to consult with states when adopting regulatory accounting standards confirms that Congress intended the Commission to implement

[8] The Commission also has explained that uniformity of accounting requirements "provides efficiency to the regulatory process for both federal and state regulators because regulators need only have expertise in one accounting system" and that "[u]niformity among states allows regulators or other interested parties to compare and benchmark the costs and rates of incumbent carriers in other states." *Phase II Order* ¶ 21.

regulations that are important to both, or either, the states and the Commission in carrying out their regulatory responsibilities. This makes sense. Absent a uniform federally mandated system of accounts, each state would be left to implement its own accounting reporting requirements in order to carry out its obligations under the Act. But that approach would be unworkable because it would result in as many as 50 different sets of accounting regulatory requirements with which carriers must comply. Obviously, such a system would be extremely burdensome to states and carriers.

The Joint Conference (at 4) also asks whether Section 11 of the Act, 47 U.S.C. § 161, generally requires the Commission to eliminate accounts that are used solely by the states. The answer is no. As noted, the Commission clearly has authority to implement accounting requirements that are used solely by the states to implement the goals of the Act. 47 U.S.C. § 220(a)(1) ("The Commission may, *in its discretion*, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this [Act]") (emphasis added). Section 11 requires the Commission to repeal or modify rules only if two conditions are present: (1) the Commission finds that there exists "meaningful economic competition" and (2) the Commission finds that "as a result" of that "meaningful economic competition" the existing regulation is "no longer necessary in the public interest." 47 U.S.C. § 161. The fact that a particular regulatory account is used only by states obviously does not mean that these conditions are satisfied. On the contrary, the Section 11 inquiry is a fact-intensive task that will depend on the particular account being analyzed and the particular economic market that the data is used to regulate. The Section 11 inquiry has little, if anything, to do with whether state or federal regulators are using that data to carry out their respective responsibilities under the Act.

In all events, a proper Section 11 inquiry shows that the Commission's regulatory accounts – including those used only by states – should not be repealed or modified. As noted, the regulatory accounting requirements serve numerous purposes, including protecting consumers and competition from the incumbent LECs' incentives to abuse market power. Facilities-based entry into local markets continues to be very limited, and there can be no serious claim that the incumbent LECs' local market power has been eliminated by competition. Thus, there is no meaningful economic competition to justify repeal or modification of the Commission's regulatory accounting requirements under Section 11.

Even if there were meaningful economic competition for local telecommunications services, that would not mean that repeal of any regulatory accounting requirements automatically is "necessary in the public interest." On the contrary, as noted, regulatory accounting data serve several purposes, many of which are unrelated to the status of facilities-based competition. As one example, the existence of facilities-based local competition (if it existed) would not affect the Commission's responsibility under the Act to implement a universal service mechanism. And, as noted, the Commission's universal service mechanism relies almost exclusively on regulatory accounting records. Thus, even with meaningful economic competition, the Commission would not be required to modify or repeal its regulatory accounting requirements under Section 11.

3. Increased Audits Of Regulatory Accounting Data. The Joint Conference (at 5) seeks comment on "[w]hether the [Commission] and/or states should increase the use of audits . . . to ensure consistency and accuracy of accounting information provided by carriers." History teaches that such audits are, in fact, necessary to assess the consistency and accuracy of the incumbent LECs' reported data. Indeed, in the last audit of the incumbent LECs' continuing property record accounts, the Commission staff discovered that the incumbents' regulatory books reflected *billions* of dollars in property that does not actually exist.[9] These inaccuracies in the incumbents' regulatory books inflate the Bells' costs, which allows them, inappropriately, to charge higher prices for access to their local networks and for unbundled network elements. Such inflated prices deter competitive entry, and ultimately harm consumers and competition.

Recent events further underscore the importance of regular audits of the incumbents' regulatory books. For example, a recent third-party audit of SBC-Pacific uncovered numerous violations of the Commission's affiliate transaction rules, *e.g.,* that SBC-Pacific and its affiliates had engaged in improper cross-subsidization, allowing Pacific to substantially understate its operating income, by, for example, paying SBC $400 million annually for Pacific's use of the SBC name in California despite the transaction providing no apparent benefits to Pacific.[10] Audits of other incumbent LECs have uncovered similar anticompetitive violations of the Commission's rules.[11]

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[9] Further Notice of Proposed Rulemaking, *1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers; Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et. al., GTE Telephone Operating Companies Release of Information Obtained During Joint Audit*, 15 FCC Rcd. 6588, ¶ 15 (2000).

[10] *See Regulatory Audit of Pacific Bell For The Years 1997, 1998, and 1999*, Overland Consulting, issued Feb. 21, 2002 and supplemented May 8, 2002 and June 20, 2002. The Audit Report is available at www.cpuc.ca.gov/static/industry/telco/supplement+report+on+and+of+pacific+bell.htm. The audit also found that that Pacific had underreported net regulated operating income to the CPUC by approximately $2 *billion* over the three-year period reviewed (1997-1999), allowing Pacific to avoid paying refunds to California consumers of approximately $350 million.

[11] *See, e.g., Implementation of the Telecommunications Act of 1996; Accounting Safeguards Under the Telecommunications Act of 1996*, Comments of AT&T Corp. on SBC's Section 272 Compliance Biennial Audit Report (filed January 29, 2003).

On this record, given the incumbents' strong incentives and established practices of violating the Act and the Commission's rules in ways that can be detected only if precise and highly disaggregated records are retained and reported, it is imperative that the Commission step up its audit procedures, by increasing the frequency of audits and the penalties for violations.

II. THE COMMISSION SHOULD CONTINUE TO REQUIRE INCUMBENTS TO REPORT DISAGGREGATED REGULATORY ACCOUNTING DATA.

There is no question that detailed regulatory accounting requirements are necessary to protect consumers and competition as the Commission implements and tests new deregulatory policies. The dominant incumbent LECs will use any small gap in those accounting requirements to hide patently anticompetitive conduct. Indeed, these LECs recently tried to defend their massive rates of return for special access services by arguing that the Commission's regulatory accounts for special access services are too aggregated to identify the exact cause of those colossal returns. The incumbents' response (although factually inaccurate) starkly confirms that detailed, disaggregated regulatory accounting data is critical to allowing the Commission and states to fine-tune deregulation and other policies, and to removing the incumbents' mainstay excuses for ignoring those accounts when they uncover market power abuses. As the telecommunications industry grows and changes, the information that should be contained in regulatory accounts will change. For now, the Commission should retain all existing regulatory accounting requirements, and implement procedures to gain additional detail with respect to certain categories of information.

1. Wholesale and retail subaccounts for Account 6620. "In response to state requests," the Commission established new "wholesale and retail subaccounts under services." *Phase II Order* ¶ 64. The Commission explained that the "wholesale versus retail distinction is important," that this distinction likely would "increase in importance as competition develops in the local exchange market," *id.*, and that "[a]dding these new subaccounts w[ould] assist the states in developing UNE rates that properly reflect the costs of providing a wholesale service." *Id.*

In the past, dominant incumbent LECs have argued that the Commission should drop these subaccounts.[12] But the records in those proceedings show that these LECs are wrong.[13] Distinct wholesale and resale accounts are important to assess the incumbent LECs' compliance with their duty "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers." 47 U.S.C. § 251(c)(4). As the Commission explained, "the per-line expenditure for customer service is higher at the retail level" in light of the fact that "CLECs (wholesale customers) do most of the customer functions themselves." *Phase II Order*, ¶ 64 & n.122. Thus, distinct wholesale and retail accounts plainly serve an important and current regulatory function.

Wholesale and resale accounts are important to states in UNE pricing proceedings. Indeed, UNE prices reflect common costs, loading factors and other overhead costs attributable to the costs of operating a "wholesale" network. In assessing those costs, state commissions routinely look to the Bells' ARMIS accounts on the theory that historical ratios of such costs to investment may serve as a proxy (or at least a starting point) for estimating forward-looking

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[12] *See, e.g.,* Petition of BellSouth, SBC and Verizon for Reconsideration of Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286, at 2-7 (filed March 8, 2002) ("Joint Petition").

[13] *See, e.g.,* NYPSC, CC Docket No. 00-199, at 1 (filed Dec. 18, 2002) (reasoning that "a breakdown of revenues and expenses by retail . . . [and] wholesale" was necessary "to accomplish the goal of monitoring competition"); GSA, CC Docket No. 00-199, at 5 (filed Dec. 18, 2002) (the "addition of wholesale and retail subaccounts to the customer operations expense account would aid greatly in the determination of appropriate resale discounts"); *see also* 47 U.S.C. § 251(c)(4); FCC NARUC *ex parte*, CC Docket No. 00-199, App. A, at 5-6 (Sept. 6, 2001) (explaining that the Commission could "use retail wholesale measures as a means of assessing ILEC market dominance").

levels of those costs. As a result, the Commission's decision to require incumbent LECs to provide distinct subaccounts for retail and wholesale costs plainly "will assist in developing UNE rates that properly reflect the costs of providing a wholesale service." *Phase II Order*, ¶ 64.

Moreover, the Commission has correctly noted that the benefit of adding these subaccounts outweighs any potential burdens. While it is clear that benefit of requiring a "wholesale/retail distinction will increase in importance as competition develops in the local exchange market" (*Phase II Order*, ¶ 64), no party has identified any particular burden associated with these reporting requirements. *Id.* Thus, the Commission correctly required that this information be reported, and should retain these accounts going forward.

2. The Commission should reinstate Account 5230. In the *Phase II Order* (¶ 36), the Commission consolidated the miscellaneous revenue accounts (Accounts 5230 through 5270) into Account 5200, a generic "Miscellaneous Revenue" account. The problem with that decision is that Account 5230 ("Directory Revenue") is not, as the Commission recognized, a miscellaneous account, but actually reflects revenues from a separate line of business. *Id*. And, as the Commission also recognized, the accounting data related to that separate line of business are very important to states as they carry out their responsibilities under the Act to protect consumers and competition against the incumbents' use of their local monopolies to gain an anticompetitive advantage in the market for directory listings. *Id.*[14]

The only reason cited by the Commission for eliminating the separate Directory Listings account is that it was not "persuaded that there continues to be regulatory benefit from a federal

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[14] *See also* Ohio CC and NASUCA Joint Comments, CC Docket No. 00-199, at 4 (filed July 21, 2001); AT&T *Ex Parte*, CC Docket No. 00-199, at 2 (filed Aug. 29, 2001).

perspective with maintaining directory revenue separately from miscellaneous revenue." *Phase II Order* ¶ 36. But as explained above, a federal benefit to retaining the data is not a necessary pre-requisite for determining whether particular information should be included in the Commission's regulatory accounting requirements. On the contrary, as noted above, Congress clearly contemplated that the Commission – in developing its regulatory accounting requirements – would assess both federal *and* state needs for accounting information. *See, e.g.,* 47 U.S.C. § 220(i).

Given that the states have articulated need for the Commission to collect these data separately, and that the Commission has explicitly recognized that the states' need for the data is legitimate, *Phase II Order* ¶ 36 ("[s]tate commenters have raised legitimate state concerns about retaining data on directory revenues separately"), the Commission should not have eliminated Account 5230.

3. New Optical Switching Account. The Commission should supplement its current uniform system of accounts by requiring dominant carriers to report information relating to optical switching. In the past, the Commission has declined to adopt new optical switching accounts on the ground that "adding the optical switching account is premature because the technology has not yet developed to the point where widespread deployment is imminent." *Phase II Order* ¶ 60. But the current level of deployment of optical switches is only one relevant factor when assessing whether to require dominant carriers to report such information, and other factors militate strongly in favor of adding a separate optical switching account.

The incumbents have argued that they should not be required to provide new switching technology, including optical switching technology, to competitors as an unbundled network element. In addition, the incumbents and states often look to historical switched costs in estimate forward-looking costs for unbundled network elements. In these circumstances, it is important to separate the costs of these various technologies to ensure informed decisionmaking.

In addition, the benefits of a separate optical switching account plainly outweigh any potential burden. Incumbents presumably already keep track of this information, as they do for non-optical switches. Moreover, to the extent that there are only a few optical switches deployed in the incumbents' networks, collecting that information should not be overly burdensome.

4. New Switching Software Account. The Commission should also add a separate account for switching software to its uniform system of accounts. In the *Phase II Order*, the Commission declined to add a separate account for switching software because it saw "no regulatory need at this time to separately track investment in switching software in a new subaccount." *Id.* ¶ 62. However, there is in fact a substantial regulatory need for a separate account for software investment. The incumbent LECs have recently, in state UNE rate proceedings, and in federal § 271 proceedings, and in universal service cost model proceedings, begun to insist that existing and new switching software have had a significant impact on their switching costs.[15] The only way to determine whether these claimed switching software costs are legitimate, and to assess the impact of those costs on UNE rates and the universal service mechanism, is to require carriers to maintain that information separately in regulatory accounts. Furthermore, the dominant incumbent LECs have offered no legitimate reason why maintaining a separate switching software account would be unduly burdensome. On the contrary, judging by the incumbents' arguments in recent § 271 proceedings, they already maintain such information.

[15] *See, e.g.,* SBC-Pacific 271 Application, Reply Comments, Declaration of Richard L. Scholl, WC Docket No. 02-306, ¶¶ 19-23 (filed November 4, 2002).

5. The Incumbent LECs Should Be Required To Report Their Aggregated Fiber And DSL Deployment In Regulated Accounts. The Commission has emphasized that there "is an immediate and pressing need to assess the penetration of fiber in the local loop and gauge the development of broadband infrastructures." *Phase II Order* ¶ 175. Accordingly, to assess fiber deployment in the local loop, the Commission now requires the largest incumbent LECs to provide information showing the number of locations where interfaces between fiber and copper (or coaxial cable) exist, and the number of switched access lines that are physically routed through those locations, aggregated by study area, in ARMIS 43-07 Reports. *See id.* nn. 332 & 333. Similarly, to measure broadband deployment over local telephone networks, the Commission now requires the largest incumbent LECs to provide the number of working digital subscriber lines ("DSL") terminated at customer premises locations, and the number of those lines that are provided through fiber/copper (or fiber/coaxial) interfaces, again aggregated by study area, in ARMIS 43-07 Reports.

The incumbent LECs have objected to providing this information in ARMIS 43-07 Reports because, they claim, fiber and DSL deployment information is confidential and, therefore, should not be made publicly available through those reports. *See* Joint Petition at 10. Instead, they urge the Commission to collect fiber and DSL deployment information in Form 477, where the Commission has instituted procedures that streamline requests for confidentiality. *See id.* This request should be rejected.

The predicate of the incumbents' argument – that the fiber and DSL deployment information to be provided in ARMIS 43-07 Reports warrants confidential treatment under the Commission's rules – is wrong. Confidential treatment is appropriate to protect data that would "assist[] competitors in preparing marketing strategies to use in direct competition with [the reporting carrier].” *Southwestern Bell Telephone Company,* Tariff FCC No. 73, DA 96-1927 (released November 19, 1996).[16] But the ARMIS 43-07 data relating to fiber and DSL deployment will be collected and reported only at the “study area” level, *see Phase II Order* ¶ 158, and thus would not provide potential competitors with competitively sensitive information that could be used to compete against incumbent LECs. The incumbent LECs provide service throughout every service area, and data showing the number of fiber/copper interfaces or DSL lines terminated by an incumbent LEC at customer premises in that study area could not remotely reveal broadband capabilities in any specific geographic area within the study area.

But even if these data were found to be confidential, the incumbents’ claim that these data would be subject to confidential treatment if reported on Form 477, but not if reported on ARMIS 43-07 Report, is specious. The Commissions’ rules would not preclude them from seeking confidential treatment merely because the information is provided in an ARMIS report. Moreover, the mere fact that information is reported on Form 477 does not guarantee confidential treatment.[17]

Finally, shifting ILEC reporting of fiber and DSL deployment to Form 477 would impose substantial new burdens on all other LECs that meet the Form 477 reporting threshold. Only the largest incumbent LECs are required to submit ARMIS 43-07 Reports, *e.g,* Qwest, SBC,

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[16] *See also Public Citizen Health Research Group* v. *FDA*, 185 F.3d 898, 905 (D.C. Cir. 1999) (noting that under the Trade Secrets Act, information is considered confidential if release of that information would result in the likelihood of substantial injury).

[17] The Commission allows for “streamlined” confidentiality request of that data (by checking a box on Form 477). *See* Report and Order, *Local Competition and Broadband Reporting*, 15 FCC Rcd. 7717, ¶ 25 (2000). But simply checking that box does not automatically protect the data from disclosure. If a third party requests access to the data, the providing carrier must make a showing that the data fall within the Commission’s confidentiality rules. The incumbent LECs, therefore, would have to demonstrate that their fiber and DSL deployment data fall within the

Verizon, and BellSouth. *See Phase II Order* ¶ 9. But *all* LECs that serve more than 10,000 or more voice-grade equivalent lines or 250 broadband lines would be subject to the new fiber and DSL fiber requirements if those reporting requirements are shifted from ARMIS 43-07 Reports to Form 477. Although the Commission has found that there are clear benefits to requiring the largest monopoly incumbent LECs – which serve the vast majority of lines – to report data relating to fiber and DSL investment, there has been no such showing that imposing such requirements on small and medium sized LECs would produce any measurable benefit. Thus, shifting fiber and DSL reporting requirements from Form 477 to ARMIS 43-07 Reports would appear to contravene the public interest, and BellSouth has made no showing to the contrary.

6. Affiliate Transaction Rules. Finally, the Commission should maintain and, indeed, strengthen its existing affiliate transaction rules, rather than adopt the rule changes contained in the *Phase 2 Order*. The need for such rules is even greater now that the Commission has begun to conduct biennial audits of the BOCs pursuant to Section 272. The first two Section 272 audits – of Verizon in New York and of SBC in Texas – have uncovered substantial misconduct and violations of Section 272.[18] On the basis of those audits, it is clear that the Commission should retain its affiliate transaction rules to ensure that it can effectively monitor and enforce both the statute and the Commission's rules.

Commission's confidentiality rules whether reported on Form 477 or provided in ARMIS 43-07 Reports.

[18] *See Implementation of the Telecommunications Act of 1996; Accounting Safeguards under the Telecommunications Act of 1996*, CC Docket No. 96-150, Comments of AT&T Corp. on SBC's Section 272 Compliance Biennial Audit Report (filed January 29, 2003); *Implementation of the Telecommunications Act of 1996; Accounting Safeguards under the Telecommunications Act of 1996*, CC Docket No. 96-150, Comments of AT&T Corp. on Verizon's Section 272 Compliance Biennial Audit Report (filed April 8, 2002).

In addition, the Commission should *extend* the scope of the affiliate transaction rules so that they apply to transactions between incumbent LECs that are owned by the same holding company in order to close a loophole that allows the Bells to game the system. For example, if SBC Pacific sells services to SBC-SWBT, those transactions are entirely unregulated and unreported under the Commission's current rules, even though such transactions can result in inappropriate shifts in cost among entities within the same holding company. Under the current rules, one ILEC can purchase services from another within the same holding company at inflated rates, and purchasing ILEC will record that inflated rate as its expense in the relevant expense account (*e.g.*, engineering). Such inflated transfer prices have no impact on the profits of the holding company, because the costs and revenues are merely being shifted from one pocket to another. By booking the inflated transaction as expenses, however, the purchasing ILEC can pass potentially inflated costs through to end-users in inflated end-user rates. Similarly, since virtually all TELRIC cost models use ARMIS reported data as inputs, these inflated transaction rates are also used to calculate UNE rates, which also become inflated.

The Commission also should not decrease the threshold for external sales from 50% to 25% when determining the prevailing price under its affiliate transaction rules. *See* 47 C.F.R. § 32.27(d); *Phase II Order* ¶¶ 93-94. Indeed, the Commission's *Phase II Order* is hardly a ringing endorsement for such a rule change; the Commission stated only that "[w]e are skeptical that it is a sustainable strategy for a firm significantly to underprice transactions with 25 percent of its customers in order to be able to record transactions at that price with an affiliate," and that it would "monitor the situation to determine whether this modification has any unintended consequences." *Phase II Order* ¶ 94. Allowing the LEC unfettered discretion to set the transaction price when as much as 75% of its revenues from those services come from its affiliates substantially increases the chance that the LEC will be able to manipulate the price. In light of recent abuses, the Commission should retain the current rule, rather than take a leap of faith, monitor the situation, and hope for the best.

CONCLUSION

For the foregoing reasons, the Commission should retain and extend its regulatory accounting requirements.

Respectfully submitted,

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January 31, 2003

CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of January, 2003, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: January 31, 2003
Washington, D.C.

/s/ Peter M. Andros

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